gain recognized from the sale of the QSB stock is $1,000.

(v) A's basis in the replacement QSB stock is $3,000 (cost of the replacement QSB stock, $5,500, reduced by the gain not recognized under section 1045, $2,500).

Example 11. Sale by partner of QSB stock received in a nonliquidating distribution. (i) The facts are the same as in *Example 10*, except that, on June 1, 2011, PRS distributes only $2,000 of the QSB stock to A, reducing A's interest in PRS capital from 60 percent to 33 percent. PRS' basis in the distributed QSB stock is $1,500. On November 1, 2011, A sells for $2,500 the QSB stock distributed by PRS to A and purchases, within 60 days of the date of sale of the QSB stock, replacement QSB stock for $2,500. A makes a timely election to apply section 1045 with respect to A's sale of the distributed QSB stock.

(ii) Under section 732, A's basis in the distributed QSB stock is $1,500. Therefore, A realizes a gain on the sale of the distributed QSB stock of $1,000. Because A made an election to apply section 1045 to the sale, and because A purchased, within 60 days of A's sale of the QSB stock, replacement QSB stock at a cost equal to the amount realized on the sale of the distributed QSB stock, A defers recognition of the gain from the sale of the QSB stock to the extent that such gain does not exceed the distribution nonrecognition limitation.

(iii) Under paragraph (e)(3) of this section, the nonrecognition limitation with respect to A's sale of the QSB stock is A's section 1045 amount realized reduced by A's section 1045 adjusted basis. Because PRS did not distribute all of the particular type of QSB stock and the distribution of the QSB stock to A was not in liquidation of A's interest in PRS, under paragraph (e)(3)(ii)(C) of this section A's section 1045 amount realized is $1,250 (A's amount realized from the sale of the distributed QSB stock, $2,500, multiplied by A's smallest percentage interest in PRS capital with respect to such stock, 50 percent). Under paragraph (e)(3)(iii)(B) of this section, A's section 1045 adjusted basis is the product of the partnership's basis in the QSB stock sold by the partner, $1,500, and A's smallest percentage interest in the partnership capital with respect to such stock, 50 percent. Therefore, A's section 1045 adjusted basis is $750 (50 percent of $1,500), and A's nonrecognition limitation amount on the sale of the QSB stock is $500 ($1,250 section 1045 amount realized minus $750 section 1045 adjusted basis). As this amount is less than the amount of gain that A is eligible to defer under section 1045, $1,000, A defers recognition of only $500 of the gain from the sale of the QSB stock. A must recognize the remaining $500 of that gain.

(iv) A's basis in the replacement QSB stock is $2,000 (cost of the replacement QSB stock, $2,500, reduced by the gain not recognized under section 1045, $500).

Example 12. Contribution of replacement QSB stock to a partnership. (i) On January 1, 2008, A, an individual, B, an individual, and X, a C corporation, form PRS, a partnership. A, B, and X each contribute $250 to PRS and agree to share all partnership items equally. On February 1, 2008, PRS purchases QSB stock for $750. PRS sells the QSB stock on November 3, 2008, for $1,050. PRS realizes $300 of gain from the sale of the QSB stock (none of which is treated as ordinary income) and allocates $100 of gain to each of its partners. PRS informs the partners that it does not intend to make an election under section 1045 with respect to the sale of the QSB stock. Each partner's share of the amount realized from the sale of the QSB stock is $350. On November 30, 2008, A, an eligible partner within the meaning of paragraph (g)(3) of this section, purchases replacement QSB stock for $350 and makes a section 1045 election under paragraph (c)(1) of this section. Subsequently, A transfers the replacement QSB stock to ABC, a partnership, in exchange for an interest in ABC.

(ii) Because A purchased within 60 days of PRS' sale of the QSB stock, replacement QSB stock for a cost equal to A's share of the partnership's amount realized on the sale of the QSB stock, and because A made a valid election to apply section 1045 with respect to A's share of the gain from PRS' sale of the QSB stock, A does not recognize A's $100 distributive share of the gain from PRS' sale of the QSB stock. Before the contribution of the replacement QSB stock to ABC, A's adjusted basis in the replacement QSB stock is $250 ($350 cost minus $100 nonrecognition amount). A does not recognize gain upon the contribution of QSB stock to ABC under section 721(a). Upon the contribution of the replacement QSB stock to ABC, A's basis in the ABC partnership interest is $250, and ABC's basis in the replacement QSB stock is $250. However, the replacement QSB stock does not qualify as QSB stock in ABC's hands. Neither A nor ABC will be eligible to defer gain under section 1045 on a subsequent sale of the replacement QSB stock.

(j) *Effective date/applicability—In general.* This section applies to sales of QSB stock on or after August 14, 2007.

[T.D. 9353, 72 FR 45349, Aug. 14, 2007, as amended by T.D. 9353, 72 FR 57487, Oct. 10, 2007]

SPECIAL RULES

§ 1.1051–1 Basis of property acquired during affiliation.

(a)(1) The basis of property acquired by a corporation during a period of affiliation from a corporation with which

it was affiliated shall be the same as it would be in the hands of the corporation from which acquired. This rule is applicable if the basis of the property is material in determining tax liability for any year, whether a separate return or a consolidated return is made in respect of such year. For the purpose of this section, the term *period of affiliation* means the period during which such corporations were affiliated (determined in accordance with the law applicable thereto), but does not include any taxable year beginning on or after January 1, 1922, unless a consolidated return was made, nor any taxable year after the taxable year 1928.

(2) The application of subparagraph (1) of this paragraph may be illustrated by the following example:

Example: The X Corporation, the Y Corporation, and the Z Corporation were affiliated for the taxable year 1920. During that year the X Corporation transferred assets to the Y Corporation for $120,000 cash, and the Y Corporation in turn transferred the assets during the same year to the Z Corporation for $130,000 cash. The assets were acquired by the X Corporation in 1916 at a cost of $100,000. The basis of the assets in the hands of the Z Corporation is $100,000.

(b) The basis of property acquired by a corporation during any period, in the taxable year 1929 or any subsequent taxable year, in respect of which a consolidated return was made or was required under the regulations governing the making of consolidated returns, shall be determined in accordance with such regulations. The basis in the case of property held by a corporation during any period, in the taxable year 1929 or any subsequent taxable year, in respect of which a consolidated return is made or is required under the regulations governing the making of consolidated returns, shall be adjusted in respect of any items relating to such period in accordance with such regulations.

(c) Except as otherwise provided in the regulations promulgated under section 1502 of the Internal Revenue Code of 1954 or the regulations under section 141 of the Internal Revenue Code of 1939 or the Revenue Act of 1938 (52 Stat. 447), 1936 (49 Stat. 1652), 1934 (48 Stat. 683), 1932 (47 Stat. 169), or 1928 (45 Stat. 791), the basis of property after a consolidated return period shall be the same as the basis immediately prior to the close of such period.

§ 1.1052–1 Basis of property established by Revenue Act of 1932.

Section 1052(a) provides that if property was acquired after February 28, 1913, in any taxable year beginning before January 1, 1934, and the basis of the property, for the purposes of the Revenue Act of 1932 (47 Stat. 169), was prescribed by section 113(a) (6), (7), or (9) of that act, then for purposes of subtitle A of the Code, the basis shall be the same as the basis prescribed in the Revenue Act of 1932. For the rules applicable in determining the basis of stocks or securities under section 113(a)(9) of the Revenue Act of 1932 in case of certain distributions after December 31, 1923, and in any taxable year beginning before January 1, 1934, see 26 CFR (1939) 39.113 (a)(12)–1 (Regulations 118).

§ 1.1052–2 Basis of property established by Revenue Act of 1934.

Section 1052(b) provides that if property was acquired after February 28, 1913, in any taxable year beginning before January 1, 1936, and the basis of the property for the purposes of the Revenue Act of 1934 (48 Stat. 683) was prescribed by section 113(a) (6), (7), or (8) of that act, then for purposes of subtitle A of the Code, the basis shall be the same as the basis prescribed in the Revenue Act of 1934. For example, if after December 31, 1920, and in any taxable year beginning before January 1, 1936, property was acquired by a corporation by the issuance of its stock or securities in connection with a transaction which is not described in section 112(b)(5) of the Internal Revenue Code of 1939 but which is described in section 112(b)(5) of the Revenue Act of 1934, the basis of the property so acquired shall be the same as it would be in the hands of the transferor, with proper adjustments to the date of the exchange.

§ 1.1052–3 Basis of property established by the Internal Revenue Code of 1939.

Section 1052(c) provides that if property was acquired after February 28,

1913, in a transaction to which the Internal Revenue Code of 1939 applied and the basis thereof was prescribed by section 113(a) (6), (7), (8), (13), (15), (18), (19) or (23) of such Code, then for purposes of subtitle A of the Internal Revenue Code of 1954, the basis shall be the same as the basis prescribed in the Internal Revenue Code of 1939. In such cases, see section 113(a) of the Internal Revenue Code of 1939 and the regulations thereunder.

§ 1.1053–1 Property acquired before March 1, 1913.

(a) *Basis for determining gain.* In the case of property acquired before March 1, 1913, the basis as of March 1, 1913, for determining gain is the cost or other basis, adjusted as provided in section 1016 and other applicable provisions of chapter 1 of the Code, or its fair market value as of March 1, 1913, whichever is greater.

(b) *Basis for determining loss.* In the case of property acquired before March 1, 1913, the basis as of March 1, 1913, for determining loss is the basis determined in accordance with part II (section 1011 and following), subchapter O, chapter 1 of the Code, or other applicable provisions of chapter 1 of the Code, without reference to the fair market value as of March 1, 1913.

(c) *Example.* The application of paragraphs (a) and (b) of this section may be illustrated by the following example:

Example: (i) On March 1, 1908, a taxpayer purchased for $100,000, property having a useful life of 50 years. Assuming that there were no capital improvements to the property, the depreciation sustained on the property before March 1, 1913, was $10,000 (5 years @ $2,000), so that the original cost adjusted, as of March 1, 1913, for depreciation sustained prior to that date is $90,000. On that date the property had a fair market value of $94,500 with a remaining life of 45 years.

(ii) For the purpose of determining gain from the sale or other disposition of the property on March 1, 1954, the basis of the property is the fair market value of $94,500 as of March 1, 1913, adjusted for depreciation allowed or allowable after February 28, 1913, computed on $94,500. Thus, the substituted basis, $94,500, is reduced by the depreciation adjustment from March 1, 1913, to February 28, 1954, in the aggregate of $86,100 (41 years @ $2,100), leaving an adjusted basis for determining gain of $8,400 ($94,500 less $86,100).

(iii) For the purpose of determining loss from the sale or other disposition of such property on March 1, 1954, the basis of the property is its cost, adjusted for depreciation sustained before March 1, 1913, computed on cost, and the amount of depreciation allowed or allowable after February 28, 1913, computed on the fair market value of $94,500 as of March 1, 1913. In this example, the amount of depreciation sustained before March 1, 1913, is $10,000 and the amount of depreciation determined for the period after February 28, 1913, is $86,100. Therefore, the aggregate amount of depreciation for which the cost ($100,000) should be adjusted is $96,100 ($10,000 plus $86,100), and the adjusted basis for determining loss on March 1, 1954, is $3,900 ($100,000 less $96,100).

(d) *Fair market value.* The determination of the fair market value of property on March 1, 1913, is generally a question of fact and shall be established by competent evidence. In determining the fair market value of stock or other securities, due regard shall be given to the fair market value of the corporate assets as of such date, and other pertinent factors. In the case of property traded in on public exchanges, actual sales on or near the basic date afford evidence of value. In general, the fair market value of a block or aggregate of a particular kind of property is not to be determined by a forced-sale price, or by an estimate of what a whole block or aggregate would bring if placed upon the market at one and the same time. In such a case the value should be determined by ascertaining as the basis the fair market value of each unit of the property. All relevant facts and elements of value as of the basic date should be considered in each case.

§ 1.1054–1 Certain stock of Federal National Mortgage Association.

(a) *In general.* The basis in the hands of the initial holder of a share of stock which is issued pursuant to section 303(c) of the Federal National Mortgage Association Charter Act (12 U.S.C., section 1718) in a taxable year beginning after December 31, 1959, shall be an amount equal to the issuance price of the stock reduced by the amount, if any, required by section 162(d) to be treated (with respect to such share) as an ordinary and necessary business expense. See section 162(d) and § 1.162–19. For purposes of this section the initial

holder is the original purchaser who is issued stock of the Federal National Mortgage Association (FNMA) pursuant to section 303(c) of the Act and who appears on the books of FNMA as the initial holder. See §1.162–19.

(b) *Example.* The provisions of this section may be illustrated by the following example:

Example: Pursuant to section 303(c) of the Federal National Mortgage Association Charter Act a certificate of FNMA stock is issued to A as of January 1, 1961. The issuance price of the stock was $100 and the fair market value of the stock on the date of issue was $69. A was required by section 162(d) to treat $31 as a business expense for the year 1961. The basis of the share of stock in the hands of A, the initial holder, shall be $69, the amount paid for the stock ($100) reduced by $31.

[T.D. 6690, 28 FR 12254, Nov. 19, 1963]

§ 1.1055–1 General rule with respect to redeemable ground rents.

(a) *Character of a redeemable ground rent.* For purposes of subtitle A of the Code (1) a redeemable ground rent (as defined in section 1055(c) and paragraph (b) of this section) shall be treated as being in the nature of a mortgage, and (2) real property held subject to liabilities under such a redeemable ground rent shall be treated as held subject to liabilities under a mortgage. Thus, under section 1055(a) and this paragraph, the transfer of property subject to a redeemable ground rent has the same effect as the transfer of property subject to a mortgage, the acquisition of property subject to a redeemable ground rent is to be treated the same as the acquisition of property subject to a mortgage, and the holding of property subject to a redeemable ground rent is to be treated in the same manner as the holding of property subject to a mortgage. See section 163(c) for the treatment of any annual or periodic rental payment under a redeemable ground rent as interest.

(b) *Definition of redeemable ground rent.* For purposes of subtitle A of the Code, the term *redeemable ground rent* means only a ground rent with respect to which all the following conditions are met:

(1) There is a lease of land which is assignable by the lessee without the consent of the lessor.

(2) The term of the lease is for a period in excess of 15 years, taking into account all periods for which the lease may be renewed at the option of the lessee.

(3) The lessee has a present or future right to terminate the lease and to acquire the lessor's interest in the land (i.e., to redeem the ground rent) by the payment of a determined or determinable amount, which amount is referred to in §§1.1055–2, 1.1055–3, and 1.1055–4 as a *redemption price.* Such right must exist by virtue of State or local law. If the lessee's right to terminate the lease and to acquire the lessor's interest is not granted by State or local law but exists solely by virtue of a private agreement or privately created condition, the ground rent is not a *redeemable ground rent.*

(4) The lessor's interest in the land subject to the lease is primarily a security interest to protect the payment to him of the annual or periodic rental payments due under the lease.

(c) *Effective date.* In general, the provisions of section 1055 and paragraph (a) of this section take effect on April 11, 1963, and apply with respect to taxable years ending on or after such date. See §1.1055–3 for rules for determining the basis of real property acquired subject to liabilities under a redeemable ground rent regardless of when such property was acquired. See also §1.1055–4 for rules for determining the basis of a redeemable ground rent in the hands of a holder who reserved or created such ground rent in connection with a transfer, occurring before April 11, 1963, of the right to hold real property subject to liabilities under such ground rent.

[T.D. 6821, 30 FR 6216, May 4, 1965]

§ 1.1055–2 Determination of amount realized on the transfer of the right to hold real property subject to liabilities under a redeemable ground rent.

In determining the amount realized from a transfer, occurring on or after April 11, 1963, of the right to hold real property subject to liabilities under a redeemable ground rent, such ground rent shall be accounted for in the same manner as a mortgage for an amount of money equal to the redemption price of

the ground rent. The provisions of this section apply in respect of any such transfer even though such ground rent was created prior to April 11, 1963. For provisions relating to the determination of the amount of and recognition of gain or loss from the sale or other disposition of property, see section 1001 and the regulations thereunder.

[T.D. 6821, 30 FR 6217, May 4, 1965]

§ 1.1055–3 Basis of real property held subject to liabilities under a redeemable ground rent.

(a) *In general.* The provisions of section 1055(a) and paragraph (a) of § 1.1055–1 are applicable in determining the basis of real property held on or after April 11, 1963, in any case where the property at the time of acquisition was subject to liabilities under a redeemable ground rent. (See section 1055(b)(2).) Thus, if on or after April 11, 1963, a taxpayer holds real property which was subject to liabilities under a redeemable ground rent at the time he acquired it, the basis of such property in the hands of such taxpayer, regardless of when the property was acquired, will include the redeemable ground rent in the same manner as if it were a mortgage in an amount equal to the redemption price of such ground rent. Likewise, if on or after April 11, 1963, a taxpayer holds real property which was subject to liabilities under a redeemable ground rent at the time he acquired it and which has a substituted basis in his hands, the basis of the property in the hands of the taxpayer's predecessor in interest is to be determined by treating the redeemable ground rent in the same manner as a mortgage in an amount equal to the redemption price of such ground rent.

(b) *Illustrations.* The provisions of this section may be illustrated by the following examples:

Example 1. On April 11, 1963, taxpayer A held residential property which he acquired on January 15, 1963, for a purchase price of $10,000 and which, at the time he acquired it, was subject to a ground rent redeemable for a redemption price of $1,600. A's basis for the property includes the purchase price ($10,000) plus the redeemable ground rent in the same manner as if it were a mortgage for $1,600.

Example 2. In 1962, taxpayer X, a corporation, acquired real property subject to a redeemable ground rent in a transfer to which section 351 (relating to transfer of property to corporation controlled by transferor) applied and in which the basis of the property to X was the transferor's basis. X still held the property on April 11, 1963. The transferor's basis in the property is to be determined by treating the redeemable ground rent to which it was subject in the transferor's hands as if it were a mortgage.

[T.D. 6821, 30 FR 6217, May 4, 1965]

§ 1.1055–4 Basis of redeemable ground rent reserved or created in connection with transfers of real property before April 11, 1963.

(a) *In general.* In the case of a redeemable ground rent created or reserved in connection with a transfer, occurring before April 11, 1963, of the right to hold real property subject to liabilities under such ground rent, the basis of such ground rent on or after April 11, 1963, in the hands of the person who reserved or created the ground rent is the amount which was taken into account in respect of such ground rent in computing the amount realized from the transfer of such real property. Thus, if no such amount was taken into account, such basis shall be determined without regard to section 1055. (See section 1055(b)(3).)

(b) The provisions of this section may be illustrated by the following examples:

Example 1. The taxpayer, who was in the business of building houses, purchased an undeveloped lot of land for $500 and built a house thereon at a cost of $10,000. Subsequently, he transferred the right to hold the lot improved by the house for a consideration of $12,000, and an annual ground rent for such property of $120 which was redeemable for a redemption price of $2,000. The taxpayer reported a $2,000 gain on the transfer, treating the amount realized as $12,000 and his cost allocable to the interest transferred as $10,000. Since the builder did not take the redeemable ground rent into account in computing gain on the transfer, his basis for such ground rent is $500 (the cost of the land not offset against the consideration received for the transfer). Thus, if he subsequently sells the redeemable ground rent (or if it is redeemed from him) for $2,000, he has no gain of $1,500 in the year of sale (or redemption).

Example 2. Assume the same facts as in Example 1 except that the builder reported a gain of $3,500 on the transfer, treating the amount realized as $14,000 ($12,000 cash plus $2,000 for the redeemable ground rent) and his costs as $10,500 ($10,000 for the house and $500 for the lot). Since the taxpayer took the

entire amount of the redeemable ground rent into account in computing his gain, his basis for such ground rent is $2,000. Thus, if he subsequently sells the redeemable ground rent (or if it is redeemed from him) for $2,000, he has no gain or loss on the transaction.

Example 3. Assume the same facts as in Example 1 except that the builder reported a gain of $3,000 on the transfer. He computed this gain by treating the amount realized as $12,000 but treating his cost allocable to the interest transferred as $12,000/$14,000ths of his total $10,500 cost, or $9,000. Since the builder still has remaining $1,500 of unallocated cost, his basis for the redeemable ground rent is $1,500. Thus, if he subsequently sells the redeemable ground rent (or if it is redeemed from him) for $2,000, he has a gain of $500 in the year of sale (or redemption).

[T.D. 6821, 30 FR 6217, May 4, 1965]

§ 1.1059(e)–1 Non-pro rata redemptions.

(a) *In general.* Section 1059(d)(6) (exception where stock held during entire existence of corporation) and section 1059(e)(2) (qualifying dividends) do not apply to any distribution treated as an extraordinary dividend under section 1059(e)(1). For example, if a redemption of stock is not pro rata as to all shareholders, any amount treated as a dividend under section 301 is treated as an extraordinary dividend regardless of whether the dividend is a qualifying dividend.

(b) *Reorganizations.* For purposes of section 1059(e)(1), any exchange under section 356 is treated as a redemption and, to the extent any amount is treated as a dividend under section 356(a)(2), it is treated as a dividend under section 301.

(c) *Effective date.* This section applies to distributions announced (within the meaning of section 1059(d)(5)) on or after June 17, 1996.

[T.D. 8724, 62 FR 38028, July 16, 1997]

§ 1.1059A–1 Limitation on taxpayer's basis or inventory cost in property imported from related persons.

(a) *General rule.* In the case of property imported into the United States in a transaction (directly or indirectly) by a controlled taxpayer from another member of a controlled group of taxpayers, except for the adjustments permitted by paragraph (c) (2) of this section, the amount of any costs taken into account in computing the basis or inventory cost of the property by the purchasing U.S. taxpayer and which costs are also taken into account in computing the valuation of the property for customs purposes may not, for purposes of the basis or inventory cost, be greater than the amount of the costs used in computing the customs value. For purposes of this section, the terms *controlled taxpayer* and *group of controlled taxpayers* shall have the meaning set forth in §1.482–1(a).

(b) *Definitions*—(1) *Import.* For purposes of section 1059A and this section only, the term *import* means the filing of the entry documentation required by the U.S. Customs Service to secure the release of imported merchandise from custody of the U.S. Customs Service.

(2) *Indirectly.* For purposes of this section, *indirectly* refers to a transaction between a controlled taxpayer and another member of the controlled group whereby property is imported through a person acting as an agent of, or otherwise on behalf of, either or both related persons, or as a middleman or conduit for transfer of the property between a controlled taxpayer and another member of the controlled group. In the case of the importation of property indirectly, an adjustment shall be permitted under paragraph (c)(2) of this section for a commission or markup paid to the person acting as agent, middleman, or conduit, only to the extent that the commission or markup: is otherwise properly included in cost basis or inventory cost; was actually incurred by the taxpayer and not remitted, directly or indirectly, to the taxpayer or related party; and there is a substantial business reason for the use of a middleman, agent, or conduit.

(c) *Customs value*—(1) *Definition.* For purposes of this section only, the term *customs value* means the value required to be taken into account for purposes of determining the amount of any customs duties or any other duties which may be imposed on the importation of any property. Where an item or a portion of an item is not subject to any customs duty or is subject to a free rate of duty, such item or portion of such item shall not be subject to the

provisions of section 1059A or this section. Thus, for example, the portion of an item that is an American good returned and not subject to duty (items 806.20 and 806.30, Tariff Schedules of the United States, 19 U.S.C. 1202); imports on which no duty is imposed that are valued by customs for statistical purposes only; and items subject to a zero rate of duty (19 U.S.C. 1202, General Headnote 3) are not subject to section 1059A or this section. Also, items subject only to the user fee under 19 U.S.C. 58(c), or the harbor maintenance tax imposed by 26 U.S.C. 4461, or only to both, are not subject to section 1059A or this section. This section imposes no limitation on a claimed basis or inventory cost in property which is less than the value used to compute the customs duty with respect to the same property. Section 1059A and this section have no application to imported property not subject to any customs duty based on value, including property subject only to a per item duty or a duty based on volume, because there is no customs value, within the meaning of this paragraph, with respect to such property.

(2) *Adjustments to customs value.* To the extent not otherwise included in customs value, a taxpayer, for purposes of determining the limitation on claimed basis or inventory cost of property under this section, may increase the customs value of imported property by the amounts incurred by it and properly included in inventory cost for—

(i) Freight charges,

(ii) Insurance charges,

(iii) The construction, erection, assembly, or technical assistance provided with respect to, the property after its importation into the United States, and

(iv) Any other amounts which are not taken into account in determining the customs value, which are not properly includible in customs value, and which are appropriately included in the cost basis or inventory cost for income tax purposes. See §1.471–11 and section 263A.

Appropriate adjustments may also be made to customs values when the taxpayer has not allocated the value of assists to individual articles but rather has reported the value of assists on a periodic basis in accordance with 19 CFR 152.103(e). When 19 CFR 152.103(e) has been utilized for customs purposes, the taxpayer may adjust his customs values by allocating the value of the assists to all imported articles to which the assists relate. To the extent that an amount attributable to an adjustment permitted by this section is paid by a controlled taxpayer to another member of the group of controlled taxpayers, an adjustment is permitted under this section only to the extent that the amount incurred represents an arm's length charge within the meaning of §1.482–1(d)(3).

(3) *Offsets to adjustments.* To the extent that a customs value is adjusted under paragraph (c)(2) of this section for purposes of calculating the limitation on claimed cost basis or inventory cost under this section, the amount of the adjustments must be offset (reduced) by amounts that properly reduce the cost basis of inventory and that are not taken into account in determining customs value, such as rebates and other reductions in the price actually incurred, effected between the purchaser and related seller after the date of importation of the property.

(4) *Application of section 1059A to property having dutiable and nondutiable portions.* When an item of imported property is subiect to a duty upon the full value of the imported article, less the cost or value of American goods returned, and the taxpayer claims a basis or inventory cost greater than the customs value reported for the item, the claimed tax basis or inventory cost in the dutiable portion of the item is limited under section 1059A and this section to the customs value of the dutiable portion under paragraph (c)(1). The claimed tax basis or inventory cost in the nondutiable portion of the item is determined by multiplying the customs value of the nondutiable portion by a fraction the numerator of which is the amount by which the claimed basis or inventory cost of the item exceeds the customs value of the item and the denominator of which is the customs value of the item and adding this amount to the customs value of the nondutiable portion of the item. The claimed tax basis or inventory cost in

the dutiable portion is determined by multiplying the customs value of the dutiable portion by a fraction the numerator of which is the amount by which the claimed basis or inventory cost of the item exceeds the customs value of the item and the denominator of which is the customs value of the item and adding this amount to the customs value of the dutiable portion of the item. However, the taxpayer may not claim a tax basis or inventory cost in the dutiable portion greater than the customs value of this portion of the item.

(5) *Allocation of adjustments to property having dutiable and nondutiable portions.* When an item of imported property is subject to a duty upon the full value of the imported article, less the cost or value of American goods returned, and the taxpayer establishes that the customs value may be increased by adjustments permitted under paragraph (c)(2) of this section for purposes of the section 1059A limitation, the taxpayer's basis or inventory cost of the dutiable portion of the item is determined by multiplying the customs value of the dutiable portion times the percentage that the adjustments represent of the total customs value of the item and adding this amount to the customs value of the dutiable portion of the item. The taxpayer's basis or inventory cost of the nondutiable portion of the item is determined in the same manner. The amount so determined for the dutiable portion of the item is the section 1059A limitation for this portion of the item.

(6) *Alternative method of demonstrating compliance.* In lieu of calculating all adjustments and offsets to adjustments to customs value for an item of property pursuant to paragraph (c) (2) and (3) of this section, a taxpayer may demonstrate compliance with this section and section 1059A by comparing costs taken into account in computing basis or inventory costs of the property and the costs taken into account in computing customs value at any time after importation, provided that in any such comparison the same costs are included both in basis or inventory costs and in customs value. If, on the basis of such comparison, the basis or inventory cost is equal to or less than the customs value, the taxpayer shall be deemed to have met the requirements of this section and section 1059A.

(7) *Relationship of section 1059A to section 482.* Neither this section nor section 1059A limits in any way the authority of the Commissioner to increase or decrease the claimed basis or inventory cost under section 482 or any other appropriate provision of law. Neither does this section or section 1059A permit a taxpayer to adjust upward its cost basis or inventory cost for property appropriately determined under section 482 because such basis or inventory cost is less than the customs value with respect to such property.

(8) *Illustrations.* The application of this section may be illustrated by the following examples:

Example 1. Corporation X, a United States taxpayer, and Y Corporation are members of a group of controlled corporations. X pays $2,000 to Y for merchandise imported into the United States and an additional $150 for ocean freight and insurance. The customs value of the shipment is determined to be the amount actually paid by X ($2,000) and does not include the charges for ocean freight and insurance. For purposes of computing the limitation on its inventory cost for the merchandise under section 1059A and this section, X is permitted, under paragraph (c)(2) of this section, to increase the customs value ($2,000) by amounts it paid for ocean freight and insurance charges ($150). Thus, the inventory cost claimed by X in the merchandise may not exceed $2,150.

Example 2. Assume the same facts as in Example 1 except that, subsequent to the date of importation of the merchandise, Y grants to X a rebate of $200 of the purchase price. At the time of sale, the rebate was contingent upon the volume of merchandise ultimately bought by X from Y. The value of the merchandise, for customs purposes, is not decreased by the rebate paid to X by Y. Therefore, the customs value, for customs purposes, of the merchandise remains the same ($2,000). For purposes of computing its inventory cost, X was permitted, under paragraph (c)(2) of this section, to increase the customs value for purposes of section 1059A of $2,000 by the amounts it paid for ocean freight and insurance charges ($150). However, under paragraph (c)(3) of this section, X is required to reduce the amount of the customs value by the lesser of the amount of the rebate or the amount of any positive adjustments to the original customs value. The inventory price claimed by X may not exceed $2,000 ($2,000 customs value, plus $150 transportation adjustment, less $150 offsetting rebate

adjustment). While X's limitation under section 1059A is $2,000, X may not claim a basis or inventory cost in the merchandise in excess of $1,950. *See* I.R.C. section 1012; and section 1.471–2.

Example 3. Corporation X, a United States taxpayer, and Y Corporation are members of a group of controlled corporations. X pays $10,000 to Y for merchandise imported into the United States. The merchandise is composed, in part, of American goods returned. The customs value of the merchandise, on which a customs duty is imposed, is determined to be $8,000 ($10,000, the amount declared by X, less $2,000, the value of the American goods returned). For income tax purposes, X claims a cost basis in the merchandise of $11,000. None of the adjustments permitted by paragraph (c)(2) of this section is applicable. The portion of the merchandise constituting American goods returned represented 20 percent of the total customs value of the merchandise. Since the cost basis claimed by X for income tax purposes represents a 10 percent increase over the customs valuation (before reduction for American goods returned), the claimed tax basis in the dutiable content is considered to be $8,800 and in the portion constituting American goods returned is $2,200. Since a customs duty was imposed only on the dutiable content of the merchandise, the limitation in section 1059A and this section is applicable only to the claimed tax basis in this portion of the merchandise. Accordingly, under paragraph (a) of this section, X is limited to a cost basis of $10,200 in the merchandise. This amount represents a cost basis of $8,000 in the dutiable content and of $2,200 in the portion of the merchandise constituting American goods returned.

Example 4. Assume the same facts as in Example 3 except that X establishes that it is entitled to increase its customs value by $1,000 in adjustments permitted by paragraph (c)(2) of this section. Since the adjustments to customs value that X is entitled to under paragraph (c)(2) of this section are 10 percent of the customs value, for purposes of determining the limitation under section 1059A and this section, both the dutiable content and the portion of the merchandise constituting American goods returned shall be increased to an amount 10 percent greater than the respective values determined for customs purposes, or $8,800 for the dutiable content and $2,200 for the portion of the merchandise constituting American goods returned. Accordingly, under paragraph (a) of this section, X is limited to a cost basis of $11,000 in the merchandise.

Example 5. Corporation X, a United States taxpayer, and Y Corporation are members of a group of controlled corporations. X pays $10,000 to Y for merchandise imported into the United States. The customs value of the merchandise, on which a customs duty is imposed, is determined to be $10,000. Subsequent to the date of importation of the merchandise, Y grants to X a rebate of $1,000 of the purchase price. The value of the merchandise, for customs purposes, is not decreased by the rebate paid to X by Y. Notwithstanding the fact that X correctly reported and paid customs duty on a value of $10,000 and that its limitation on basis or inventory cost under this section is $10,000, X may not claim a basis or inventory cost in the merchandise in excess of $9,000. *See* I.R.C. section 1012; and section 1.471–2.

Example 6. Corporation X, a United States taxpayer, and Y Corporation are members of a group of controlled corporations. X pays $5,000 to Y for merchandise imported into the United States. The merchandise is not subject to a customs duty or is subject to a free rate of duty and is valued by customs solely for statistical purposes. Accordingly, pursuant to paragraph (c)(1) of this section, the merchandise is not subject to the provisions of section 1059A or this section.

Example 7. Assume the same facts as in Example 6, except that the merchandise is subject to a customs duty based on value and that the customs value (taking into account no costs other than the value of the goods) is determined to be $5,000. Assume further that the $5,000 payment is only for the value of the goods, no other cost is reflected in that payment, and only the $5,000 payment to Y is reflected in X's inventory cost or basis prior to inclusion of any other amounts properly included in inventory or cost basis. Pursuant to paragraph (c)(6) of this section, X, by demonstrating these facts is deemed to meet the requirements of this section and section 1059A.

Example 8. Corporation X, a United States taxpayer, and Y Corporation are members of a group of controlled corporations. X pays $9 to Y for merchandise imported into the United States and an additional $1 for ocean freight. The customs value of the article does not include the $1 paid for ocean freight. Furthermore, for customs purposes the value is calculated pursuant to computed value and is determined to be $8. For purposes of computing the limitation on its inventory cost for the article under section 1059A and this section, X is permitted, under paragraph (c)(2) of this section, to increase the customs value ($8) by the amount it paid for ocean freight ($1). Thus, the inventory cost claimed by X in the article may not exceed $9.

(9) *Averaged customs values.* In cases of transactions in which (i) an appropriate transfer price is properly determined for tax purposes by reference to events occurring after importation, (ii) the value for customs purposes of one article is higher and of a second article is lower than the actual transaction

values, (iii) the relevant articles have been appraised on the basis of a value estimated at the time of importation in accordance with customs regulations, and (iv) the entries have been liquidated upon importation, the section 1059A limitation on the undervalued article may be increased up to the amount of actual transaction value by the amount of the duty overpaid on the overvalued article times a fraction the numerator of which is ''1'' and the denominator of which is the rate of duty on the undervalued article. This paragraph (c)(9) applies exclusively to cases of property imported in transactions that are open for tax purposes in which the actual transaction value cannot be determined and the entry has been liquidated for customs purposes on the basis of a value estimated at the time of importation in accordance with customs regulations; in these cases, the property is appropriately valued for tax purposes by reference to a formula, in existence at the time of importation, based on subsequent events and valued for customs purposes by a different formula. This paragraph (c)(9) does not apply where customs value is correctly determined for purposes of liquidating the entry and where the customs value is subsequently adjusted for tax purposes, for example by a rebate, under paragraph (c)(2) of this section. The application of paragraph (c)(9) may be illustrated by the following example:

Example: Corporation X, a United States taxpayer, and Y Corporation are members of a group of controlled corporations. X purchases Articles A and B from Y on consignment and imports the Articles into the United States. The purchase price paid by X will be determined as a percentage of the sale prices that X realizes. Rather than deferring liquidation, customs liquidates the entry on the basis of estimated values and the customs duties are paid by X. Ultimately, it is determined that Article A was undervalued and Article B was overvalued by X for customs purposes. The section 1059A limitation for Article A is computed as follows:

	Article A	Article B
Finally-determined customs value	$9	$9
Transaction value	$10	$5
Duty rate	10%	5%
Customs duty paid	$.90	$.45
Duty overpaid or (underpaid)	($.10)	$.20

The section 1059A limitation on Article A may be increased by the amount of the duty over-paid on Article B, $.20, times 1/.10, up to the amount of the transaction value. Therefore, the section 1059A limitation on Article A is $9.00 plus $1.00, or a total of $10.00. The section 1059A limitation on Article B is reduced (but never below transaction value) by $2.00 to $7.00.

(d) *Finality of customs value and of other determinations of the U.S. Customs Service.* For purposes of section 1059A and this section, a taxpayer is bound by the finally-determined customs value and by every final determination made by the U.S. Customs Service, including, but not limited to, dutiable value, the value attributable to the cost or value of products of the United States, and classification of the product for purposes of imposing any duty. The customs value is considered to be finally determined, and all U.S. Customs Service determinations are considered final, when liquidation of the entry becomes final. For this purpose, the term *liquidation* means the ascertainment of the customs duties occurring on the entry of the property, and liquidation of the entry is considered to become final after 90 days following notice of liquidation to the importer, unless a protest is filed. If the importer files a protest, the customs value will be considered finally determined and all other U.S. Customs Service determinations will be considered final either when a decision by the Customs Service on the protest is not contested after expiration of the period allowed to contest the decision or when a judgment of the Court of International Trade becomes final. For purposes of this section, any adjustments to the customs value resulting from a petition under 19 U.S.C. section 1516 (requests by interested parties unrelated to the importer for redetermination of the appraised value, classification, or the rate of duty imposed on imported merchandise) or reliquidation under 19 U.S.C. section 1521 (reliquidation by the Customs Service upon a finding that fraud was involved in the original liquidation) will not be taken into account. However, reliquidation under 19 U.S.C. section 1501 (voluntary reliquidation by the Customs Service within 90 days of the original liquidation to

correct errors in appraisement, classification, or any element entering into a liquidation or reliquidation) or reliquidation under 19 U.S.C. section 1520(c)(1) (to correct a clerical error, mistake of fact, or other inadvertance within one year of a liquidation or reliquidation) will be taken into account in the same manner as, and take the place of, the original liquidation in determining customs value.

(e) *Drawbacks.* For purposes of this section, a drawback, that is, a refund or remission (in whole or in part) of a customs duty because of a particular use made (or to be made) of the property on which the duty was assessed or collected, shall not affect the determination of the customs value of the property.

(f) *Effective date.* Property imported by a taxpayer is subject to section 1059A and this section if the entry documentation required to be filed to obtain the release of the property from the custody of the United States Customs Service was filed after March 18, 1986. Section 1059A and this section will not apply to imported property where (1) the entry documentation is filed prior to September 3, 1987; and (2) the importation was liquidated under the circumstances described in paragraph (c)(9) of this section.

[T.D. 8260, 54 FR 37311, Sept. 8, 1989]

§ 1.1060–1 Special allocation rules for certain asset acquisitions.

(a) *Scope*—(1) *In general.* This section prescribes rules relating to the requirements of section 1060, which, in the case of an applicable asset acquisition, requires the transferor (the seller) and the transferee (the purchaser) each to allocate the consideration paid or received in the transaction among the assets transferred in the same manner as amounts are allocated under section 338(b)(5) (relating to the allocation of adjusted grossed-up basis among the assets of the target corporation when a section 338 election is made). In the case of an applicable asset acquisition described in paragraph (b)(1) of this section, sellers and purchasers must allocate the consideration under the residual method as described in §§ 1.338–6 and 1.338–7 in order to determine, respectively, the amount realized from, and the basis in, each of the transferred assets. For rules relating to distributions of partnership property or transfers of partnership interests which are subject to section 1060(d), see § 1.755–2T.

(2) *Effective dates*—(i) *In general.* The provisions of this section apply to any asset acquisition occurring after March 15, 2001. However, paragraphs (b)(9) and (c)(5) of this section apply only to applicable asset acquisitions occurring on or after April 10, 2006. A purchaser or a seller may make an irrevocable election to apply the rules in §§ 1.338–11 (including the applicable provisions in §§ 1.197–2(g)(5), 1.381(c)(22)–1, 846 and 1060) to an applicable asset acquisition occurring before April 10, 2006. Paragraph (a)(2)(ii) of this section describes the time and manner of the election for the purchaser and paragraph (a)(2)(iii) of this section prescribes the time and manner of the election for the seller. The seller may make the election to apply the regulations retroactively without regard to whether the purchaser also makes the election. For rules applicable to asset acquisitions on or before March 15, 2001, *see* § 1.1060–1T in effect before March 16, 2001 (*see* 26 CFR part 1 revised April 1, 2000).

(ii) *Time and manner of making the election for the purchaser.* The purchaser may make an election described in this paragraph (a)(2) by attaching a statement to its original or amended income tax return for the taxable year that includes the applicable asset sale. The statement must be entitled ''Election to Retroactively Apply the Rules in § 1.338–11 (Including the Applicable Provisions in §§ 1.197–2(g)(5), 1.381(c)(22)–1, 846 and 1060) to an Applicable Asset Acquisition Completed Before April 10, 2006'' and must include the following information—

(A) The name and E.I.N. for the purchaser; and

(B) The following declaration (or a substantially similar declaration): The purchaser has amended its income tax returns for the taxable year that includes the applicable asset acquisition and for all affected subsequent years to reflect the rules in § 1.338–11 (Including the Applicable Provisions in §§ 1.197–2(g)(5), 1.381(c)(22)–1,846 and 1060).

(iii) *Time and manner of making the election for the seller.* The seller may make an election described in this paragraph (a)(2) by attaching a statement to its original or amended income tax return for the taxable year that includes the applicable asset sale. The statement must be entitled ''Election to retroactively apply the rules in §1.338–11 (including the applicable provisions in §§1.197–2(g)(5), 1.381(c)(22)–1, 846 and 1060) to an applicable asset acquisition completed before April 10, 2006'' and must include the following information—

(A) The name and E.I.N. for the seller; and

(B) The following declaration (or a substantially similar declaration): The seller has amended its income tax returns for the taxable year that includes the applicable asset acquisition and for all affected subsequent years to reflect the rules in §1.338–11 (including the applicable provisions in §§1.197–2(g)(5), 1.381(c)(22)–1, 846 and 1060).

(3) *Outline of topics.* In order to facilitate the use of this section, this paragraph (a)(3) lists the major paragraphs in this section as follows:

(a) Scope.
(1) In general.
(2) Effective date.
(3) Outline of topics.
(b) Applicable asset acquisition.
(1) In general.
(2) Assets constituting a trade or business.
(i) In general.
(ii) Goodwill or going concern value.
(iii) Factors indicating goodwill or going concern value.
(3) Examples.
(4) Asymmetrical transfers of assets.
(5) Related transactions.
(6) More than a single trade or business.
(7) Covenant entered into by the seller.
(8) Partial non-recognition exchanges.
(9) Insurance business.
(c) Allocation of consideration among assets under the residual method.
(1) Consideration.
(2) Allocation of consideration among assets.
(3) Certain costs.
(4) Effect of agreement between parties.
(5) Insurance business.
(d) Examples.
(e) Reporting requirements.
(1) Applicable asset acquisitions.
(i) In general.
(ii) Time and manner of reporting.
(A) In general.
(B) Additional reporting requirement.
(C) Election described in §1.338–6(c)(5).
(2) Transfers of interests in partnerships.

(b) *Applicable asset acquisition*—(1) *In general.* An applicable asset acquisition is any transfer, whether direct or indirect, of a group of assets if the assets transferred constitute a trade or business in the hands of either the seller or the purchaser and, except as provided in paragraph (b)(8) of this section, the purchaser's basis in the transferred assets is determined wholly by reference to the purchaser's consideration.

(2) *Assets constituting a trade or business*—(i) *In general.* For purposes of this section, a group of assets constitutes a trade or business if—

(A) The use of such assets would constitute an active trade or business under section 355; or

(B) Its character is such that goodwill or going concern value could under any circumstances attach to such group.

(ii) *Goodwill or going concern value.* Goodwill is the value of a trade or business attributable to the expectancy of continued customer patronage. This expectancy may be due to the name or reputation of a trade or business or any other factor. Going concern value is the additional value that attaches to property because of its existence as an integral part of an ongoing business activity. Going concern value includes the value attributable to the ability of a trade or business (or a part of a trade or business) to continue functioning or generating income without interruption notwithstanding a change in ownership. It also includes the value that is attributable to the immediate use or availability of an acquired trade or business, such as, for example, the use of the revenues or net earnings that otherwise would not be received during any period if the acquired trade or business were not available or operational.

(iii) *Factors indicating goodwill or going concern value.* In making the determination in this paragraph (b)(2), all the facts and circumstances surrounding the transaction are taken into account. Whether sufficient consideration is available to allocate to goodwill or going concern value after the residual method is applied is not

relevant in determining whether goodwill or going concern value could attach to a group of assets. Factors to be considered include—

(A) The presence of any intangible assets (whether or not those assets are section 197 intangibles), provided, however, that the transfer of such an asset in the absence of other assets will not be a trade or business for purposes of section 1060;

(B) The existence of an excess of the total consideration over the aggregate book value of the tangible and intangible assets purchased (other than goodwill and going concern value) as shown in the financial accounting books and records of the purchaser; and

(C) Related transactions, including lease agreements, licenses, or other similar agreements between the purchaser and seller (or managers, directors, owners, or employees of the seller) in connection with the transfer.

(3) *Examples.* The following examples illustrate paragraphs (b)(1) and (2) of this section:

Example 1. S is a high grade machine shop that manufactures microwave connectors in limited quantities. It is a successful company with a reputation within the industry and among its customers for manufacturing unique, high quality products. Its tangible assets consist primarily of ordinary machinery for working metal and plating. It has no secret formulas or patented drawings of value. P is a company that designs, manufactures, and markets electronic components. It wants to establish an immediate presence in the microwave industry, an area in which it previously has not been engaged. P is acquiring assets of a number of smaller companies and hopes that these assets will collectively allow it to offer a broad product mix. P acquires the assets of S in order to augment its product mix and to promote its presence in the microwave industry. P will not use the assets acquired from S to manufacture microwave connectors. The assets transferred are assets that constitute a trade or business in the hands of the seller. Thus, P's purchase of S's assets is an applicable asset acquisition. The fact that P will not use the assets acquired from S to continue the business of S does not affect this conclusion.

Example 2. S, a sole proprietor who operates a car wash, both leases the building housing the car wash and sells all of the car wash equipment to P. S's use of the building and the car wash equipment constitute a trade or business. P begins operating a car wash in the building it leases from S. Because the assets transferred together with the asset leased are assets which constitute a trade or business, P's purchase of S's assets is an applicable asset acquisition.

Example 3. S, a corporation, owns a retail store business in State X and conducts activities in connection with that business enterprise that meet the active trade or business requirement of section 355. P is a minority shareholder of S. S distributes to P all the assets of S used in S's retail business in State X in complete redemption of P's stock in S held by P. The distribution of S's assets in redemption of P's stock is treated as a sale or exchange under sections 302(a) and 302(b)(3), and P's basis in the assets distributed to it is determined wholly by reference to the consideration paid, the S stock. Thus, S's distribution of assets constituting a trade or business to P is an applicable asset acquisition.

Example 4. S is a manufacturing company with an internal financial bookkeeping department. P is in the business of providing a financial bookkeeping service on a contract basis. As part of an agreement for P to begin providing financial bookkeeping services to S, P agrees to buy all of the assets associated with S's internal bookkeeping operations and provide employment to any of S's bookkeeping department employees who choose to accept a position with P. In addition to selling P the assets associated with its bookkeeping operation, S will enter into a long term contract with P for bookkeeping services. Because assets transferred from S to P, along with the related contract for bookkeeping services, are a trade or business in the hands of P, the sale of the bookkeeping assets from S to P is an applicable asset acquisition.

(4) *Asymmetrical transfers of assets.* A purchaser is subject to section 1060 if—

(i) Under general principles of tax law, the seller is not treated as transferring the same assets as the purchaser is treated as acquiring;

(ii) The assets acquired by the purchaser constitute a trade or business; and

(iii) Except as provided in paragraph (b)(8) of this section, the purchaser's basis in the transferred assets is determined wholly by reference to the purchaser's consideration.

(5) *Related transactions.* Whether the assets transferred constitute a trade or business is determined by aggregating all transfers from the seller to the purchaser in a series of related transactions. Except as provided in paragraph (b)(8) of this section, all assets

transferred from the seller to the purchaser in a series of related transactions are included in the group of assets among which the consideration paid or received in such series is allocated under the residual method. The principles of §1.338–1(c) are also applied in determining which assets are included in the group of assets among which the consideration paid or received is allocated under the residual method.

(6) *More than a single trade or business.* If the assets transferred from a seller to a purchaser include more than one trade or business, then, in applying this section, all of the assets transferred (whether or not transferred in one transaction or a series of related transactions and whether or not part of a trade or business) are treated as a single trade or business.

(7) *Covenant entered into by the seller.* If, in connection with an applicable asset acquisition, the seller enters into a covenant (e.g., a covenant not to compete) with the purchaser, that covenant is treated as an asset transferred as part of a trade or business.

(8) *Partial non-recognition exchanges.* A transfer may constitute an applicable asset acquisition notwithstanding the fact that no gain or loss is recognized with respect to a portion of the group of assets transferred. All of the assets transferred, including the non-recognition assets, are taken into account in determining whether the group of assets constitutes a trade or business. The allocation of consideration under paragraph (c) of this section is done without taking into account either the non-recognition assets or the amount of money or other property that is treated as transferred in exchange for the non-recognition assets (together, the non-recognition exchange property). The basis in and gain or loss recognized with respect to the non-recognition exchange property are determined under such rules as would otherwise apply to an exchange of such property. The amount of the money and other property treated as exchanged for non-recognition assets is the amount by which the fair market value of the non-recognition assets transferred by one party exceeds the fair market value of the non-recognition assets transferred by the other (to the extent of the money and the fair market value of property transferred in the exchange). The money and other property that are treated as transferred in exchange for the non-recognition assets (and which are not included among the assets to which section 1060 applies) are considered to come from the following assets in the following order: first from Class I assets, then from Class II assets, then from Class III assets, then from Class IV assets, then from Class V assets, then from Class VI assets, and then from Class VII assets. For this purpose, liabilities assumed (or to which a non-recognition exchange property is subject) are treated as Class I assets. See *Example 1* in paragraph (d) of this section for an example of the application of section 1060 to a single transaction which is, in part, a non-recognition exchange.

(9) *Insurance business.* The mere reinsurance of insurance contracts by an insurance company is not an applicable asset acquisition, even if it enables the reinsurer to establish a customer relationship with the owners of the reinsured contracts. However, a transfer of an insurance business is an applicable asset acquisition if the purchaser acquires significant business assets, in addition to insurance contracts, to which goodwill and going concern value could attach. For rules regarding the treatment of an applicable asset acquisition of an insurance business, see paragraph (c)(5) of this section.

(c) *Allocation of consideration among assets under the residual method*—(1) *Consideration.* The seller's consideration is the amount, in the aggregate, realized from selling the assets in the applicable asset acquisition under section 1001(b). The purchaser's consideration is the amount, in the aggregate, of its cost of purchasing the assets in the applicable asset acquisition that is properly taken into account in basis.

(2) *Allocation of consideration among assets.* For purposes of determining the seller's amount realized for each of the assets sold in an applicable asset acquisition, the seller allocates consideration to all the assets sold by using the residual method under §§1.338–6 and 1.338–7, substituting consideration for ADSP. For purposes of determining the

purchaser's basis in each of the assets purchased in an applicable asset acquisition, the purchaser allocates consideration to all the assets purchased by using the residual method under §§1.338–6 and 1.338–7, substituting consideration for AGUB. In allocating consideration, the rules set forth in paragraphs (c)(3) and (4) of this section apply in addition to the rules in §§1.338–6 and 1.338–7.

(3) *Certain costs.* The seller and purchaser each adjusts the amount allocated to an individual asset to take into account the specific identifiable costs incurred in transferring that asset in connection with the applicable asset acquisition (e.g., real estate transfer costs or security interest perfection costs). Costs so allocated increase, or decrease, as appropriate, the total consideration that is allocated under the residual method. No adjustment is made to the amount allocated to an individual asset for general costs associated with the applicable asset acquisition as a whole or with groups of assets included therein (e.g., non-specific appraisal fees or accounting fees). These latter amounts are taken into account only indirectly through their effect on the total consideration to be allocated. If an election described in §1.338–6(c)(5) is made with respect to an applicable asset acquisition, any allocation of costs pursuant to this paragraph (c)(3) shall be made as if such election had not been made. The preceding sentence applies to applicable asset acquisitions occurring on or after September 11, 2007. For applicable asset acquisitions occurring before September 11, 2007, and on or after September 15, 2004, see §1.1060–1T as contained in 26 CFR Part 1 in effect on April 1, 2007. For applicable asset acquisitions occurring before September 15, 2004, see §§1.338–6 and 1.1060–1 as contained in 26 CFR Part 1 in effect on April 1, 2004.

(4) *Effect of agreement between parties.* If, in connection with an applicable asset acquisition, the seller and purchaser agree in writing as to the allocation of any amount of consideration to, or as to the fair market value of, any of the assets, such agreement is binding on them to the extent provided in this paragraph (c)(4). Nothing in this paragraph (c)(4) restricts the Commissioner's authority to challenge the allocations or values arrived at in an allocation agreement. This paragraph (c)(4) does not apply if the parties are able to refute the allocation or valuation under the standards set forth in *Commissioner* v. *Danielson*, 378 F.2d 771 (3d Cir.), *cert. denied*, 389 U.S. 858 (1967) (a party wishing to challenge the tax consequences of an agreement as construed by the Commissioner must offer proof that, in an action between the parties to the agreement, would be admissible to alter that construction or show its unenforceability because of mistake, undue influence, fraud, duress, etc.).

(5) *Insurance business.* If the trade or business transferred is an insurance business, the rules of this paragraph (c) are modified by the principles of §1.338–11(a) through (d). However, in transactions governed by section 1060, such principles apply even if the transfer of the trade or business is effected in whole or in part through indemnity reinsurance rather than assumption reinsurance, and, for the insurer or reinsurer, an insurance contract (including an annuity or reinsurance contract) is a Class VI asset regardless of whether it is a section 197 intangible. In addition, the principles of §1.338–11(f) through (h) apply if the transfer occurs in connection with the complete liquidation of the transferor.

(d) *Examples.* The following examples illustrate this section:

Example 1. (i) On January 1, 2001, A transfers assets X, Y, and Z to B in exchange for assets D, E, and F plus $1,000 cash.

(ii) Assume the exchange of assets constitutes an exchange of like-kind property to which section 1031 applies. Assume also that goodwill or going concern value could under any circumstances attach to each of the DEF and XYZ groups of assets and, therefore, each group constitutes a trade or business under section 1060.

(iii) Assume the fair market values of the assets and the amount of money transferred are as follows:

Asset	Fair market value
By A:	
X	$ 400
Y	400
Z	200

Asset	Fair market value
Total	1,000
By B:	
D	40
E	30
F	30
Cash (amount)	1,000
Total	1,100

(iv) Under paragraph (b)(8) of this section, for purposes of allocating consideration under paragraph (c) of this section, the like-kind assets exchanged and any money or other property that are treated as transferred in exchange for the like-kind property are excluded from the application of section 1060.

(v) Since assets X, Y, and Z are like-kind property, they are excluded from the application of the section 1060 allocation rules.

(vi) Since assets D, E, and F are like-kind property, they are excluded from the application of the section 1060 allocation rules. Thus, the allocation rules of section 1060 do not apply in determining B's gain or loss with respect to the disposition of assets D, E, and F, and the allocation rules of section 1060 and paragraph (c) of this section are not applied to determine A's bases of assets D, E, and F. In addition, $900 of the $1,000 cash B gave to A for A's like-kind assets (X, Y, and Z) is treated as transferred in exchange for the like-kind property in order to equalize the fair market values of the like-kind assets. Therefore, $900 of the cash is excluded from the application of the section 1060 allocation rules.

(vii) $100 of the cash is allocated under section 1060 and paragraph (c) of this section.

(viii) A received $100 that must be allocated under section 1060 and paragraph (c) of this section. Since A transferred no Class I, II, III, IV, V, or VI assets to which section 1060 applies, in determining its amount realized for the part of the exchange to which section 1031 does not apply, the $100 is allocated to Class VII assets (goodwill and going concern value).

(ix) B gave A $100 that must be allocated under section 1060 and paragraph (c) of this section. Since B received from A no Class I, II, III, IV, V, or VI assets to which section 1060 applies, the $100 consideration is allocated by B to Class VII assets (goodwill and going concern value).

Example 2. (i) On January 1, 2001, S, a sole proprietor, sells to P, a corporation, a group of assets that constitutes a trade or business under paragraph (b)(2) of this section. S, who plans to retire immediately, also executes in P's favor a covenant not to compete. P pays S $3,000 in cash and assumes $1,000 in liabilities. Thus, the total consideration is $4,000.

(ii) On the purchase date, P and S also execute a separate agreement that states that the fair market values of the Class II, Class III, Class V, and Class VI assets S sold to P are as follows:

Asset class	Asset	Fair market value
II	Actively traded securities	$500
	Total Class II	500
III	Accounts receivable	200
	Total Class III	200
V	Furniture and fixtures	800
	Building	800
	Land	200
	Equipment	400
	Total Class V	2,200
VI	Covenant not to compete	900
	Total Class VI	900

(iii) P and S each allocate the consideration in the transaction among the assets transferred under paragraph (c) of this section in accordance with the agreed upon fair market values of the assets, so that $500 is allocated to Class II assets, $200 is allocated to the Class III asset, $2,200 is allocated to Class V assets, $900 is allocated to Class VI assets, and $200 ($4,000 total consideration less $3,800 allocated to assets in Classes II, III, V, and VI) is allocated to the Class VII assets (goodwill and going concern value).

(iv) In connection with the examination of P's return, the Commissioner, in determining the fair market values of the assets transferred, may disregard the parties' agreement. Assume that the Commissioner correctly determines that the fair market value of the covenant not to compete was $500. Since the allocation of consideration among Class II, III, V, and VI assets results in allocation up to the fair market value limitation, the $600 of unallocated consideration resulting from the Commissioner's redetermination of the value of the covenant not to compete is allocated to Class VII assets (goodwill and going concern value).

(e) *Reporting requirements*—(1) *Applicable asset acquisitions*—(i) *In general.* Unless otherwise excluded from this requirement by the Commissioner, the seller and the purchaser in an applicable asset acquisition each must report information concerning the amount of consideration in the transaction and its allocation among the assets transferred. They also must report information concerning subsequent adjustments to consideration.

(ii) *Time and manner of reporting*—(A) *In general.* The seller and the purchaser each must file asset acquisition statements on Form 8594, ''Asset Allocation Statement,'' with their income tax returns or returns of income for the taxable year that includes the first date assets are sold pursuant to an applicable asset acquisition. This reporting requirement applies to all asset acquisitions described in this section. For reporting requirements relating to asset acquisitions occurring before March 16, 2001, as described in paragraph (a)(2) of this section, see the temporary regulations under section 1060 in effect prior to March 16, 2001 (see 26 CFR part 1 revised April 1, 2000).

(B) *Additional reporting requirement.* When an increase or decrease in consideration is taken into account after the close of the first taxable year that includes the first date assets are sold in an applicable asset acquisition, the seller and the purchaser each must file a supplemental asset acquisition statement on Form 8594 with the income tax return or return of income for the taxable year in which the increase (or decrease) is properly taken into account.

(C) *Election described in § 1.338–6(c)(5)—*(*1*) *Availability.* The election described in §1.338–6(c)(5) is available in respect of an applicable asset acquisition provided that the requirements of that section are satisfied. Such election may be made by the seller, regardless of whether the purchaser also makes the election, and may be made by the purchaser, regardless of whether the seller also makes the election.

(*2*) *Time and manner of making election.* The election described in §1.338–6(c)(5) is made by taking a position on a timely filed original tax return for the taxable year of the applicable asset acquisition that is consistent with having made the election.

(*3*) *Irrevocability of election.* The election described in §1.338–6(c)(5) is irrevocable.

(*4*) *Effective/applicability date.* This paragraph (e)(1)(ii)(C) applies to applicable asset acquisitions occurring on or after September 11, 2007. For applicable asset acquisitions occurring before September 11, 2007 and on or after September 15, 2004, see §1.1060–1T as contained in 26 CFR Part 1 in effect on April 1, 2007. For applicable asset acquisitions occurring before September 15, 2004, see §§1.338–6 and 1.1060–1 as contained in 26 CFR Part 1 in effect on April 1, 2004.

(2) *Transfers of interests in partnerships.* For reporting requirements relating to the transfer of a partnership interest, *see* §1.755–1(d).

[T.D. 8940, 66 FR 9954, Feb. 13, 2001, as amended by T.D. 9059, 68 FR 34299, June 9, 2003; T.D. 9158, 69 FR 55742, Sept. 16, 2004; T.D. 9257, 71 FR 18006, Apr. 10, 2006; T. D. 9358, 72 FR 51706, Sept. 11, 2007; T.D. 9377, 73 FR 3874, Jan. 23, 2008; T.D. 9377, 73 FR 14386, Mar. 18, 2008]

CHANGES TO EFFECTUATE F.C.C. POLICY

§ 1.1071–1 Gain from sale or exchange to effectuate policies of Federal Communications Commission.

(a)(1) At the election of the taxpayer, section 1071 postpones the recognition of the gain upon the sale or exchange of property if the Federal Communications Commission grants the taxpayer a certificate with respect to the ownership and control of radio broadcasting stations which is in accordance with subparagraph (2) of this paragraph. Any taxpayer desiring to obtain the benefits of section 1071 shall file such certificate with the Commissioner of Internal Revenue, or the district director for the internal revenue district in which the income tax return of the taxpayer is required to be filed.

(2)(i) In the case of a sale or exchange before January 1, 1958, the certificate from the Federal Communications Commission must clearly identify the property and show that the sale or exchange is necessary or appropriate to effectuate the policies of such Commission with respect to the ownership and control of radio broadcasting stations.

(ii) In the case of a sale or exchange after December 31, 1957, the certificate from the Federal Communications Commission must clearly identify the property and show that the sale or exchange is necessary or appropriate to effectuate a change in a policy of, or the adoption of a new policy by, such Commission with respect to the ownership and control of radio broadcasting stations.

(3) The certificate shall be accompanied by a detailed statement showing